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1990 EXECUTIVE-COMPENSATION SURVEY

THE TAKE AT THE TOP

JEFFREY BANKS, FOUNDER AND CEO OF METROPOLITAN OUTDOOR ADVERTISING CORP.

THE SURVEY
Who Makes What

THE STRATEGIES
Opportunities You May Be Missing

THE CASE STUDY
The "Perfect" Plan

THE INTERVIEW
Motivating in Hard Times

PLUS:
Telemarketing Programs That Work
The Right Plans for Raising Money

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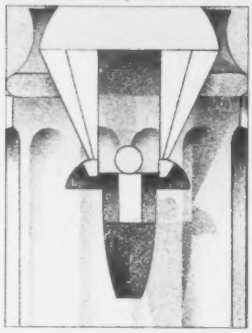

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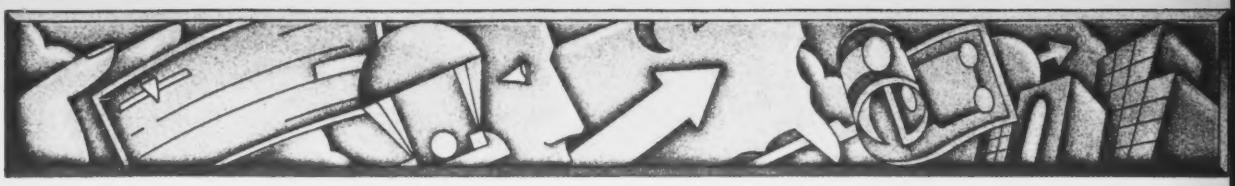
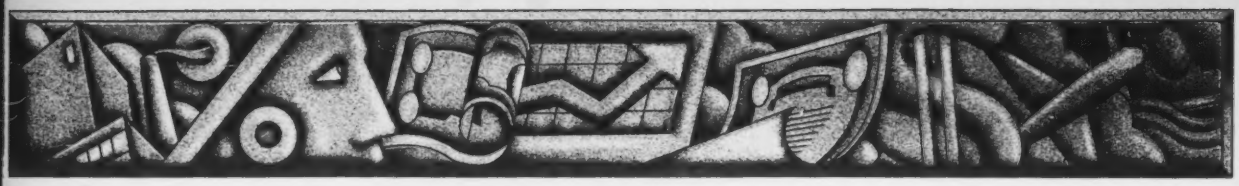


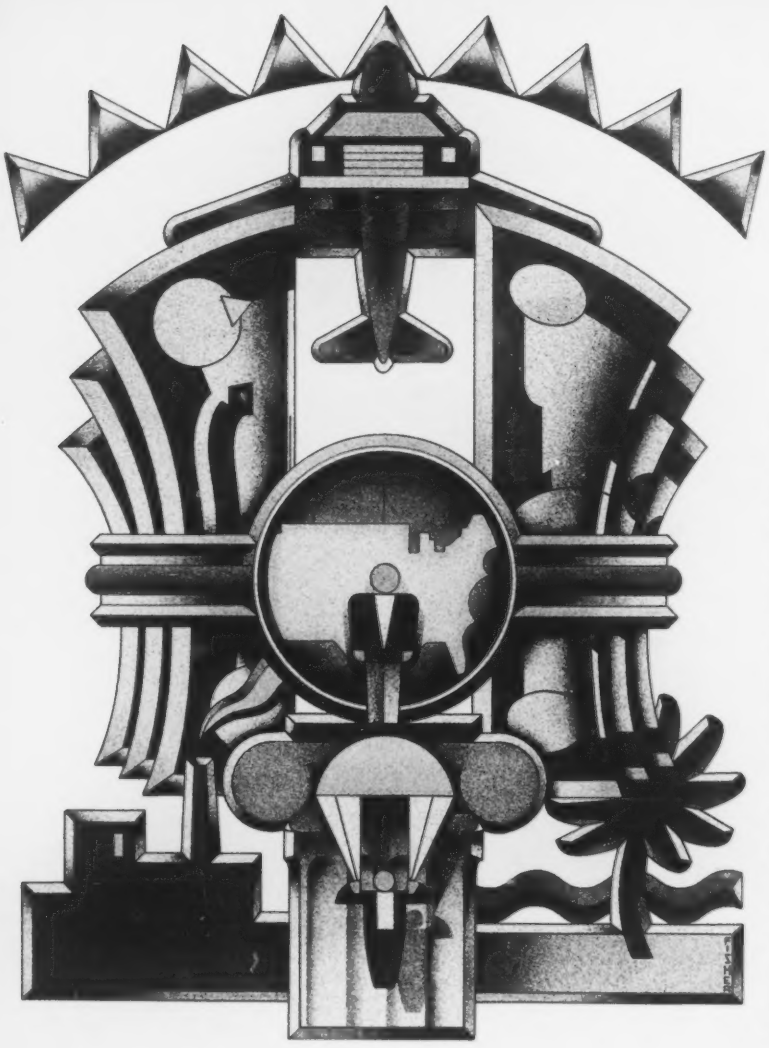
Small companies may claim they treat their people better, but when it comes to designing compensation packages, the real story this year is one missed opportunity after another

MISSED OPPORTUNITIES

All too many of the companies that participated in this year's executive-compensation survey are competing in the job market with executive-compensation packages that are pale imitations of those offered by large corporations. It's a real problem. Those companies, which have sales averaging about $5.2 million and are otherwise quite shrewd when it comes to such financial matters as building sales or boosting profit margins, are passing up fabulous compensation alternatives, many of them subsidized by Uncle Sam in the form of valuable tax deductions. Fifty-six percent of respondents reported that their payroll costs had placed an increasingly large burden on operating expenses during the past two years. But instead of looking for ways to reduce that burden through noncash compensation and tax-advantage benefits, they continued to focus on salary and bonus as the keys to recruiting executives. That's a dangerous game, since it pits fast-growing companies that are often strapped for capital against larger, better-heeled competitors. A quick look at the survey results shows an unfortunate tendency toward

BY JILL ANDRESKY FRASER





quick-gratification, cash-intensive benefits. Sixty-one percent of the survey respondents gave their chief manufacturing officers a company car—and even more did likewise for their chief operating officers and chief sales officers. But only 19% gave their manufacturing executives the opportunity to delay taxes and save for retirement through any form of deferred compensation. And a paltry 5% opted for such incentives as phantom stock or restricted stock for their executives.

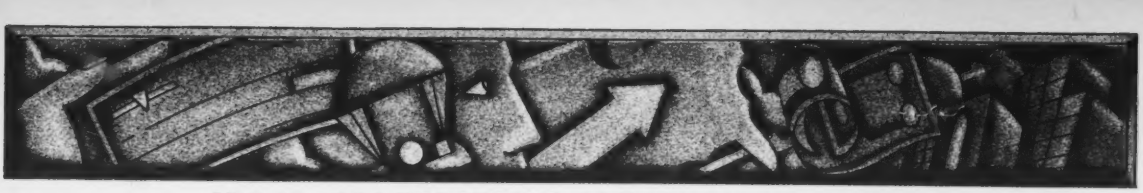
And the beat goes on. Seventy-nine percent or more relied on cash bonuses to retain top operating, manufacturing, financial, sales, and marketing executives, despite the fact that bonuses drain working capital and as outright gifts do nothing to tie valuable people to companies over the long term. Meanwhile, just 35% used profit-sharing plans, which can be combined with vesting programs to reduce executives' tax bills and virtually guarantee executive longevity.

What's the problem? In large part it's that many compensation and benefits strategies are simply more complex than straight cash rewards are. Anita Carlson, president and CEO of Five-O Advertising Inc., a $1-million Portland, Ore., business, is a good example of a company owner who is frustrated by the difficulties involved in setting up a creative benefits program. She plans to retire in eight years and has been trying to figure out a way to prepare her executives to buy out the business then, perhaps through an employee stock purchase plan (a benefit offered by only 6% of the companies surveyed). So far she hasn't been able to settle on a strategy that will meet her needs. "I've been reading books and talking to consultants, but everything's geared to large corporations," says Carlson. "Nothing really seems right for our size company at our stage of development."

Many complain about bad experiences with overpriced, underproductive consultants. "We paid a consultant $24,000 to do a compensation study and wound up learning less than we already knew from reading the want ads in our Sunday newspaper," says George Hatfield, CEO of $35-million Hatfield & Co., of Mesquite, Tex., which distributes instrumentation, piping specialties, and filtration systems.

No wonder so many owner-managers of growing companies believe they must develop their own executive-compensation strategies. William Reidy is chairman and CEO of Fine Organics Corp., an $8.2-million specialty-chemical manufacturer located in Lodi, N.J., one of the 2% of businesses surveyed that offer phantom stock to executives. (Phantom stock is a contractual promise to pay key

ILLUSTRATIONS MARK FISHER



employees a sum equal to the rise in value of a hypothetical amount of company stock, usually over a specified time period.) "We had to reinvent the wheel when we set it up," he recalls. "We had a plan from a consultant that was so convoluted we wound up taking the concept and developing our own simplified version."

The trouble is that if entrepreneurs are forced to come up with their own executive-compensation strategies, they often wind up drawing on what they already know—rather than using some of the state-of-the-art strategies that can actually be tailored to their own particular needs. Sometimes that can produce exciting results, but more often than not CEOs remain either dissatisfied with what they've done or uncertain about what to try next.

"I wanted to treat my employees like owners and have them make decisions as if this were their own company, so I set up a phantom stock program," confides Larry Baum, president and chief executive of $2-million Computing Center, of Ithaca, N.Y. "But every member of my experimental group left, including the chief operating officer and the vice-president of sales. Maybe it was the wrong idea. Maybe it was the wrong people. I'm back to square one."

George Hatfield's greatest frustration is the tremendous limits he sees in finding ways to keep himself, his partner, and other key executives happy on the compensation front. "The federal government has eliminated everything besides the 401(k) plan, and look how much they've cut back on that," he complains. "Being able to put away $7,000 or so a year in retirement savings just doesn't add up to much for me or my executives. And there simply aren't any other options."

The good news is, Hatfield is wrong. There are plenty of cost-effective ways to keep executives loyal and productive over the long term—in many cases while producing bottom-line benefits. (See box, "The Executive-Compensation Strategist," below.)

The bad news is, it takes some self-education, on the part of CEOs and their management teams, to learn about the universe of compensation options. But with 75% of the companies surveyed this year confident that their sales will rise during the course of the year—and nearly as many (66%) projecting that their profits will increase—there has never been a better time to start. ❑

Research assistance was provided by Anne Murphy.

THE EXECUTIVE-COMPENSATION STRATEGIST

Six opportunities you may be missing out on

There are plenty of cost-effective ways to keep executives loyal and productive over the long term. Some you should consider:

■ **401(k)s.** These plans allow employees to defer part of their salaries and make withdrawals at age 59 1/2 without penalty, thereby earning current tax deductions and tax-deferred interest on retirement savings. There are ways to enhance 401(k) options: Robert Funk of Express Services Temporary & Permanent Personnel, in Oklahoma City, set up a two-tier 401(k) plan that's open to all employees but provides corporate matching funds to department managers and directors at a higher percentage.

■ **Phantom stock.** For owners who want to share the rewards of their companies' growth without creating a class of minority shareholders, here's an alternative. Phantom stock mimics the performance of real stock, since there is a contractual agreement for the company to pay key employees at specified intervals for any increases in the company's market value. Employees often prefer this to outright stock gifts, because there's no income-tax liability when the phantom stock contract is signed. Employees are taxed only when payments occur.

■ **Restricted stock awards.** If your executives want to own stock, this is a way to minimize your company's risks. Restricted stock awards come with plenty of strings attached. Executives gain full ownership after a vesting period and can sell their shares back to the company only at specified intervals.

■ **Incentive stock options.** Under the right conditions—such as in a company that plans to go public—ISOs are a good incentive. They give executives the right to buy stock at a discounted price at some specified future date. The executives expect that ultimately they will be able to sell their shares at a profit.

■ **Secular trusts.** A secular trust provides one way to hold payments in a deferred-compensation plan. Companies can use secular trusts to set aside large sums for their executives' future needs and ideally tie executives to them over the long term. The trusts provide companies with an immediate tax deduction, but executives must pay current taxes on the money that goes into the trusts, which is certainly a disadvantage from their standpoint. But for people working for cash-strapped businesses, there's an advantage: since secular trust funds are segregated from working capital, employees' deferred compensation is secure.

■ **Rabbi trusts.** If your company doesn't need an immediate tax deduction, these provide a vehicle for setting deferred-compensation funds aside so executives pay taxes only when funds are distributed—at which point the company finally gets to record its tax deduction.

EXECUTIVE-COMPENSATION SURVEY (continued)

THE SURVEY

THE COMPANY

A profile of the typical company

Total sales (FY 1989)	$5,235,380
Sales growth (FYs 1988–89)	10%
Number of employees (FY 1989)	66
1989 payroll	$1,380,630
Payroll as a percentage of sales	31%
Sales per employee	$136,870
Percentage of companies surveyed that are privately owned	97%

THE CEO: A profile of the typical chief executive officer

Total compensation	$100,984
Base salary	$79,854
Bonus*	$40,300
Equity held†	68%

COMPANY-WIDE BENEFITS

INSURANCE BENEFITS Type of insurance	% of companies offering group insurance	Average % paid by company
Life	66%	92%
Medical	84	88
Dental	41	83
Short-term disability	36	91
Long-term disability	33	87

RETIREMENT BENEFITS Type of retirement benefit	% of companies offering it
Profit sharing	35%
Thrift/savings plan	9
Defined benefit trust	9
401(k)	21
Employee stock purchase plan	6
Other	7

EXECUTIVE BENEFITS AND PERKS

	CEO	COO	CFO	CSO**
Company car	77%	69%	52%	70%
Supplemental life insurance	54	49	45	41
Tax-return preparation	46	32	24	18
Supplemental medical insurance	34	32	31	30
Personal-tax & financial planning	28	14	15	12
Low- or no-interest loans	17	14	14	12
Deferred compensation	15	13	16	15
Supplemental retirement benefits	13	12	12	12
First-class air travel	9	6	5	4
Relocation allowance	5	6	8	8
Golden parachute	3	5	5	3

* 85% of CEOs surveyed receive a bonus; † 97% of CEOs surveyed have equity; ** chief sales officer

AVERAGE TOTAL PAY BY REGION

	CEO	COO	CFO	CSO
Northeast	$99,880	$71,022	$65,508	$76,029
Southeast	101,096	66,323	59,221	64,849
Midwest	99,309	73,177	51,531	64,632
Southwest	106,504	96,673	52,660	60,906
West Coast	101,484	95,397	66,364	57,983
TOTAL U.S.	100,984	78,667	59,144	65,030

AVERAGE TOTAL PAY BY INDUSTRY

	CEO	COO	CFO	CSO
Construction	$113,777	$88,656	$47,045	$55,264
Distribution	98,747	71,456	53,576	76,676
Manufacturing	121,757	88,251	58,995	72,087
Retail	89,160	63,291	47,030	42,059
Service	89,700	72,255	62,465	58,976

AVERAGE TOTAL PAY BY COMPANY SIZE

Size (in terms of sales)	CEO	COO	CFO	CSO
$10 million or more	$194,089	$126,569	$82,549	$85,824
$5 million to $9.99 million	137,942	76,108	53,201	70,877
$1 million to $4.99 million	107,461	78,595	50,283	63,838
Less than $1 million	56,385	43,733	40,759	33,030

HOW THE STUDY WAS CONDUCTED

The 1990 Executive-Compensation Study was conducted jointly by INC. and Coopers & Lybrand. In June we mailed a four-page questionnaire to 21,500 subscribers. The 823 responses were tabulated by Harrison & Goldberg, a consulting and opinion-research firm in Cambridge, Mass.

The survey was conducted under the direction of INC. special projects editor Sara Baer-Sinnott. Michael Lew, partner and regional director of compensation consulting at Coopers & Lybrand, and David Darrow, a Coopers & Lybrand compensation consultant, provided technical assistance in developing the questionnaire. A special report containing the complete results of the survey is available. The report—while preserving the confidentiality of the survey responses—provides more detailed information than we have space to publish. To obtain a copy, fill out the postpaid card bound in this issue or send a written request and a check for $98 ($95, plus $3 shipping and handling) to 1990 Executive-Compensation Study, P.O. Box 1365, Wilkes-Barre PA 18703, or call (800) 372-0018, extension 10.

EXECUTIVE-COMPENSATION SURVEY (continued)

Jeffrey Banks's company is living proof that innovative compensation strategies aren't just for the *Fortune* 500

STATE OF THE ART

Many owners of fast-growing companies complain that they don't have the time or the money to put together a comprehensive executive-compensation plan. Jeffrey Banks knows otherwise. The 44-year-old founder and chief executive of Metropolitan Outdoor Advertising Corp., one of the country's largest billboard advertising firms, built a $30-million company using one management principle. "I wanted to run a business that was responsible to my employees as well as my shareholders," he says.

In an industry in which competition for both billboard locations and customers is fierce, Banks needs to be able to recruit and retain top marketing and management talent. He founded Metropolitan 12 years ago with $500,000 in profits from a small billboard company he had owned and sold.

At first Banks and his wife, Karen, were Metropolitan's sole employees, but from the time his first billboard on the San Francisco Bay Bridge netted him Qantas Airways as a client, he used cash flow to finance some additional leases and hire a small sales force. Thanks to the couple's good eye for properties and tight fist when it came to controlling operating expenses, the company was

BY JILL ANDRESKY FRASER

PHOTOGRAPHS: TOM ZIMBEROFF

Jeffrey Banks, founder of Metropolitan Outdoor Advertising Corp.
He wanted to share his success with his employees.

in the black by the end of its first year. Then Karen, a former banker, negotiated a line of credit that helped finance the acquisition of a tiny company whose chief assets were some undervalued billboards with high-glitz potential. But, says Jeffrey Banks, "I knew if I wanted to hold on to the people I was hiring, I would have to share the benefits of my success with them."

So Banks, a former middle linebacker with the Cincinnati Bengals and the New York Jets, read up on executive compensation. Quickly he realized that the best executive-compensation plans operated like jigsaw puzzles, with various pieces that could be divvied up among the key players in a company. Some pieces could be designed according to an individual executive's—or the owner's—needs; others could be shared among all employees. As companies grew larger and more profitable, additional pieces could be added to the puzzle. And as long as the overall plan was well designed, pieces could be subtracted during capital-intensive or difficult business phases.

The first piece of Metropolitan's executive-compensation puzzle was a profit-sharing plan Banks instituted in 1980 for the company's 12 employees, including himself and his wife. It was a particularly golden year for Metropolitan, and Banks realized the company was generating more cash flow than it needed to support the next year's growth plan. So he allocated a share of profits to each employee, based on his or her salary. The funds were deposited in a retirement account in each employee's name.

Flexibility was the byword of that early plan: Banks made no guarantees about the level or even the frequency of contributions. But he made contributions during 7 of the next 11 years, and as the staff grew he also maintained his original goal of keeping what is often used solely as an executive benefit as a company-wide program.

The question arose of what to do with all those dollars once they were segregated into the individual retirement plans. Banks wanted his employees' retirement money to be managed conservatively and profitably, so he brought in Steve Adams, a managing director at Van Kasper & Co., a regional brokerage firm in San Francisco, to direct an investment program that divides assets 50-50 between growth-oriented stocks and bonds. The program has averaged a 13.5% annual rate of return.

Karen Banks

By the mid-1980s Banks felt he had to come up with other ways of binding his top employees to the company. Metropolitan had expanded into billboard markets in southern California, Texas, Idaho, and elsewhere, which meant he needed to rely on his regional managers for much of the company's site selection, marketing development, and day-to-day office supervision.

So in 1985 he divided his company into seven corporations, drawn up according to regional markets, with stock that was wholly owned by his holding company, Metropolitan Outdoor Advertising. That gave Banks the stock of eight companies (including the holding company) to play with when he devised incentive packages that would motivate his key employees.

The next year he brought in a new regional manager with an incentive package that included the potential to earn a stake of up to 5% in his local division. Eventually three other regional managers came on board with the same plan. But while it was appealing as a way of locking each executive's financial future in to his division's growth and profitability, the method had its drawbacks. "As the divisions kept growing, it became increasingly difficult to keep tracking the different stocks' values," says Banks. He remained convinced about the benefits of stock ownership as a way to motivate managers, but he was willing to consider alternative incentive methods.

Banks investigated a phantom stock plan. "At first I didn't get it," he says. "If executives didn't actually receive stock, where were the benefits and performance incentives?" But he was willing to give it a try. After all, his employees would be able to earn the same capital-gains profits (as long as the company's market value kept rising) that they would have gotten from true stock ownership. But because no shares of stock changed hands, there would be no tax bill for employees until the phantom stock payouts occurred.

The new plan was a success. "One type of phantom stock is so much easier to administer than the stock of seven divisions," Banks says, "and it still works great as a way to motivate executives."

But Banks didn't stop there. He set up a pool containing 8% of his holding company's stock, to be awarded on a discretionary basis to Metropolitan's most valuable executives and regional managers. "I'll always maintain majority control of our board, but this is another way of tying our top performers to the company's future," he says. So far, he has distributed just under half of the pool's stock.

For all of Banks's best intentions, executive compensation has occasionally taken a hit at Metropolitan. The most recent dates back to last year's $27-million acquisition of a billboard firm, which was financed primarily through bank loans. "We've got covenants tied to our current leverage that will make it difficult for us to do very much in the way of executive compensation for the next 18 to 24 months," he acknowledges.

The profit-sharing plan is bearing the brunt of that. Banks doesn't anticipate being able to make any new contributions in the near future. The money in the retirement plan continues to grow, however. Most Metropolitan executives also continue to build long-term rewards through the performance of their phantom stock *(continued)*

shares, whose value is tied to the company's overall performance.

Executives and other employees also receive annual cash bonuses, set at levels appropriate for the current austerity. Banks doesn't, however. "The way our bonuses are set up, I don't receive anything till we hit our top numbers—which we haven't made yet."

Banks has found a way to improve his employees' compensation despite his current financial restrictions. Last year he created a 401(k) plan that he merged with a 401(k) that already existed at one of the companies he had recently acquired. The plan's low administrative cost made it simple for Metropolitan's bankers to live with, just as long as Banks promised not to match employee contributions until he met his various operating goals. Twenty-five percent of his employees joined—not bad for the first year—and now defer about $2,000 worth of salary each month.

What's the payoff from all the personal attention to compensation matters? A work force that, in Banks's eyes, "understands that we're all a family working toward a common goal, toward rewards we're all going to share." That may sound like California dreaming. But Metropolitan's record of success is pure reality. ❑

THE TAKE AT THE TOP

How CEOs set their own compensation

If there are no easy answers in executive compensation, that's particularly true when company owners have to decide how much to take out of their businesses for themselves, and when. Take out too much too soon and they risk crippling their growing businesses; yet if they fail to diversify their finances beyond the business as soon as that's feasible, they risk sacrificing their family's financial future to the company. What's a CEO to do?

"Since there's no real formula to rely on, it's a matter of conscience," says Joe Schulman, president of Sentry Chemical Co., an Atlanta manufacturer of cleaning compounds with annual sales of about $7 million. "I develop a number based on my productivity and the company's profitability, and then ask myself what people in my shop would say if they knew what I earned." Among the companies surveyed, the average base salary for CEOs was nearly $80,000. The bigger the company, the likelier it was that the chief executive took home a good bit more: CEOs at companies with sales of $1 million to $4.9 million had an average total compensation of $107,461; when sales topped $10 million, the CEO's total pay averaged a much more generous $194,089.

Those numbers sound positively utopian to many struggling business owners who continue to make financial sacrifices long after their companies pass beyond the initial, precarious phase of operations. "We live moderately and have few financial needs," says Gregory Turner, whose Saginaw, Mich., business, Turner Business Forms Inc., is eight years old. Although his revenues top $1 million annually, Turner still takes home a salary that's a small fraction of the survey average. "I'm not one for the yachts and big cars. I tell my wife the equity we're building for ourselves in the business is the big thing."

Generally speaking, it's more the size of one's ambitions than the size of one's company that determines how much an owner takes out of the business. "I'm 41, and I have virtually no assets outside of this company," admits Mike Slataper, whose Mansfield, Tex., construction business, Ramtech Modular Design Inc., has grown to $12.8 million in sales. "That's because I have goals that go far beyond our being a $15-million company. And you're not going to grow like that if you're raping your business of its capital." Nor are you going to survive hard times and achieve those larger ambitions, most CEOs agree, if you're not willing to cut your own compensation when it's in the company's best interests. "In hard times, I've cut my salary down to grocery money," says A. J. Adolph, whose Automotive Casualty Insurance Co., in Kenner, La., now boasts double-digit profit margins and $50 million in sales. "Hell, I've sold my car when times were bad."

Not surprisingly, those kinds of sacrifices instill a zest for enjoying the good times when entrepreneurs think their businesses can finally support them. "For the first 20 years, I worked 18 hours a day, seven days a week, and didn't take a big salary because I was building up inventory, buying machinery, and accumulating retained earnings. But now my son and son-in-law can earn more than $240,000 a year and I earn far more than that," says Leonard Silverstein, founder of $5-million Terrace Paper Co., of Cicero, Ill. "If I were the head of General Motors, I'd have to answer to my shareholders. But I work for myself and my family. When I think I have enough money retained in the business, it's stupid not to take it out."

Most of the survey respondents are still committed to sharing the rewards of success with their top executives. Respondents paid an average of $65,497 in base salary and $19,749 in bonuses (when paid) to their COOs. Chief sales officers averaged $54,794 in salary and another $15,550 in bonuses for those who got them. In fact, quite a few CEOs were quicker to reward their executives than themselves. Robert A. Funk of Express Services Temporary & Permanent Personnel, in Oklahoma City, sounds almost wistful as he comments, "Our bonus system has always been one of our company's biggest strengths in attracting and retaining top people. And once the company finally reaches a certain level of profitability, my partner and I are definitely going to start taking bonuses ourselves."

HARD TIMES

Successful growing companies often find a number of ways to share their success with employees. But what happens when a once-bustling business hits a downturn? How do you reward and motivate employees when you can no longer afford even slight increases in pay? And what's the best role for the CEO?

Certainly, that isn't an easy shift for either employees or managers. But in the view of Warren Blaisdell, the secret to keeping people motivated during lean times is plenty of communication. Blaisdell, 54, spent more than 20 years at the Norton Co., a manufacturer of abrasives and engineering materials based in Worcester, Mass., where he designed a variety of innovative systems for improving productivity in highly competitive businesses. For the past decade he has worked as an organizational consultant specializing in devising performance-based compensation packages; he's currently a senior consultant with William M. Mercer Inc., an international employee benefits and compensation firm with headquarters in New York City. Late last summer executive editor Nancy J. Lyons and senior writer Bruce G. Posner spoke with Blaisdell.

You've depended on profits to compensate and motivate employees. So what do you do when profits begin to evaporate?

INC.: Many of the companies we know build the lion's share of their nonsalaried compensation around profit sharing. The funding pool for those plans is profits, but in a slowdown that source is threatened. What sorts of problems does that create?

BLAISDELL: Well, it certainly presents some major disappointments to those who have grown accustomed to profit-sharing benefits. But if you stop to think about it, profit sharing by its very nature isn't guaranteed. It's built on risk, and inherent in that risk is the possibility that in some periods there won't be enough profit to enable a payout.

INC.: That may be, but do you think most people understand it that way? If the business has been growing and making money for five or six years, don't most employees expect those payouts to continue through thick and thin? *(continued)*

Warren Blaisdell, senior consultant at William M. Mercer Inc.
'In difficult times performance feedback for individuals becomes *more* critical.'

PHOTOGRAPHS: JON GOELL

BLAISDELL: They do, and the first time the payouts are cut or eliminated, there's a lot of disappointment and concern. To a degree, though, the reaction is going to be a function of how well the plan and the conditions for payout have been explained. If the plan has been well communicated, it won't be a total surprise when you're not able to pay. As the business runs into harder times, it will be obvious to employees that this period is different. Ideally, they're hearing about problems along the way.

INC.: Are you talking about posting financials on the bulletin board?

BLAISDELL: That's one way to do it, but it's not the only way. You can structure your goals according to how much detail you want to provide. In some cases, we've been able to set up targets and then measure performance in relation to them. You can say, "If we meet 80% of our target, then we will pay out *X*."

INC.: But why should employees believe they haven't reached the 80% level if they don't see the actual numbers?

BLAISDELL: Well, you need to establish credibility. Without a level of trust, you're going to have problems under any system. Successful plans, whether you share detailed financial results or not, are built on continual feedback. You can't wait until the end of the year to say, "Sorry folks, we didn't make it." One way or another, you need to find a way to give people regular information about how the business is doing, why it's doing well or not so well, what they can do to change or reinforce the outcome in the future. You want to find a vehicle for getting people more focused on the business.

INC.: Sounds as if you're advocating a lot of regular meetings. But most company owners aren't really inclined to talk much when the business is having trouble. And where would they find the time?

BLAISDELL: You really have to make time, even when other demands may seem greater. The most important time to communicate, to spend an hour or so with your employees, is when you're having problems. Memos don't do it. There's no substitute for hearing directly from the chief executive officer.

INC.: When profits are squeezed, companies look for all sorts of ways to cut back. They eliminate positions and freeze salaries. But how do you keep people from getting demoralized by these actions? Does it make sense to say, for instance, "We can't give you the raise now, but maybe in six months"? Or do you tell your employees to forget about it until next year?

BLAISDELL: I think you want to hold out the opportunity. If you've frozen employee salaries, you should be able to say, "Your performance warrants an increase, but because of our circumstances we can't pay it." There's nothing wrong with telling people you plan to review things in six months or whenever the situation changes.

INC.: Say you find you can't afford raises and you can't contribute to profit sharing. What do you do about performance reviews? Do you skip them or go ahead with them?

BLAISDELL: In difficult times I think performance feedback for individuals becomes *more* critical than it is in good times. When people are concerned about the business and about the future, the more you can tell them about how they're doing and how they can improve, the better they feel.

INC.: You've talked about the need for information, updates, and explaining the business and what needs to happen. What things should managers avoid doing in downturns?

BLAISDELL: What they shouldn't do is hunker down or clam up. People sense problems anyway, especially in small companies. They know what's going on, and the more you try to hide, the more susceptible the environment will be to rumors and misleading information. Without information, people will assume things are worse than they are. You don't create or remodel executive offices or buy expensive company cars. If pay cuts are occurring, make sure managers are feeling the impact, too. Certainly, you don't want to create a situation in which managers are benefiting from cutbacks. I've seen instances in which management bonuses were paid on the basis of work-force reductions. Let me tell you, it sends a pretty negative message.

INC.: Should managers be wary of investing in new products or new businesses when employees are being asked to suffer?

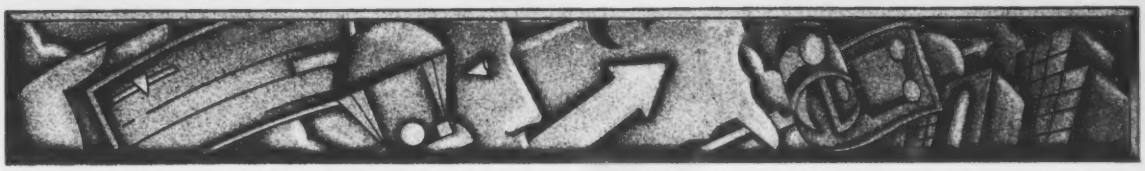
BLAISDELL: Quite the contrary. I think such actions can be viewed very positively as an attempt to turn the business around, that is, if they're adequately explained. Again, it goes back to communication. People want to know what you're doing, why you're doing it, where it might lead, and what it means to them. If the new ventures are intended, at least in part, to provide opportunities for your present employees, then they will want to hear that.

INC.: Say you can't justify any profit-sharing distributions based on your current performance but intend to reward people when performance improves. Can you create incentive plans that are driven by factors other than profit? How do you go about it?

BLAISDELL: Many companies design incentives that focus on specific operating areas where they think improvements are possible. Maybe capacity is constrained, and unless you find a way to increase productivity, you'll have to add more equipment or add on to the facility. Or maybe the amount of material you use is excessive; lowering waste would result in very tangible cost savings. If you focus on those choke points and make improvements, you can reward people accordingly.

INC.: There are obvious opportunities in manufacturing settings, but how might that apply to other kinds of businesses?

BLAISDELL: The approach lends itself to any business in which people work together to produce a tangible output. For example, in a financial-services organization or in the accounting department of *(continued)*



any company, you may have thousands of transactions. Productivity, therefore, is critical. Incentives based on the volume of work or the quality of data entry would be an obvious thing to explore. You need to identify what's critical to the success of the business. I know of some younger companies that reward executives for meeting cash-flow goals. For them, that's the most important thing.

INC.: How quickly should you pull the plug when you find an incentive is having undesirable side effects?

BLAISDELL: My attitude is that you need to be willing to review, modify, and update anytime the business and the way you operate change. You might have new equipment, or you might have new products. If there's one thing we can say with certainty these days, it's that changes will continue to occur and will ultimately have an impact on your incentive plans. Even if you aren't aware of problems, every incentive plan should be reviewed annually. In fact, you may want to have sunset provisions in which plans automatically expire at the end of a year. Then you can see what you want to do for the coming period.

Remember, the whole idea here is to motivate people to change behavior and improve performance. If people aren't responding, you've got a problem. You need to figure out what's going on.

INC.: OK, say we're getting people to focus. Waste is down, results are looking better, but we're still losing money. Where do we find the money to pay the bonuses?

BLAISDELL: Well, payouts from some plans are driven by cost improvements—gains in productivity, quality, or whatever. You share the gains with the people who achieve it.

INC.: CEOs should dip into their pockets? Remember, this business is still in the red.

BLAISDELL: Yes, but you're still in operation, and you're spending less than you otherwise would. The incentive funds come from the reduced or avoided costs.

INC.: We see what you're saying. But don't CEOs have problems with that?

BLAISDELL: If the goal is to operate more efficiently and employees have worked hard and achieved that, a lot of managers I've worked with are happy to pay out the money.

INC.: Couldn't you create a threshold of profitability and say, "We won't pay out a dime until we earn *X*"?

BLAISDELL: Certainly. Cash profit-sharing incentive plans tie the organization and its employees together in shared success.

INC.: What's the downside?

BLAISDELL: The downside is that employees may not see a direct relationship between their efforts and the financial success of the organization. They could do everything right, meet all the productivity goals you set, and receive nothing. That's a hard message for a manager to deliver. An alternative is to design a system in which the incentive opportunity is tempered by profitability but not totally eliminated.

INC.: Say your business is slowing down or has already slowed down. Is this the time to think about some new incentives?

BLAISDELL: Depending on the circumstances, it could be an ideal time.

INC.: How do you get started? What's the best way to pitch a new incentive system?

BLAISDELL: I'd start by not even focusing on pay and incentives. I'd start by communicating what the business needs are, what the challenges are, how you'll be organizing the business as a whole and the role of each work group, what types of performance you'll be looking for, how you'll measure it, and what steps people will need to take to bring this improvement about. After I'd gone through all that, I'd decide whether these changes are so critical to the success of the company that I'd be willing to tie pay to them. But I wouldn't talk about pay until I'd established what it is we're trying to accomplish and how best to make it happen.

INC.: We've talked about company-wide incentives and incentives for smaller groups. When you're in the midst of a downturn, what kinds of things can you do for the managers you don't want to lose?

BLAISDELL: Some private companies set up long-term cash bonuses when they know they're not going to be paying an annual bonus. They tell managers they'll get *X*% of this year's pay later on—assuming the company meets its performance goals over the next two or three years.

Beyond this, there's phantom stock. Usually, it means giving a manager appreciation rights on, for example, hypothetical stock shares based on book value or actual stock value over a period of time. In private companies, phantom stock has some real advantages over other kinds of equity arrangements, although it can create a significant cash obligation down the line. In general, my feeling is that these incentives will help to retain your key people only if they believe in what you are doing and feel committed to the business.

INC.: So the CEO has to sell them on the future? How do you convince people that it will be worth their while to stick around?

BLAISDELL: The best way I know of is to infect them with your enthusiasm and conviction about the potential and future of the business. You need to reach out to your people and communicate your optimism and enlist their support. Motivated people are the strongest vehicle for improving performance that a manager has. You've got to be able to make the business tangible, to show people there really are customers out there who buy this product and who are the source of all revenue and potential for future growth.

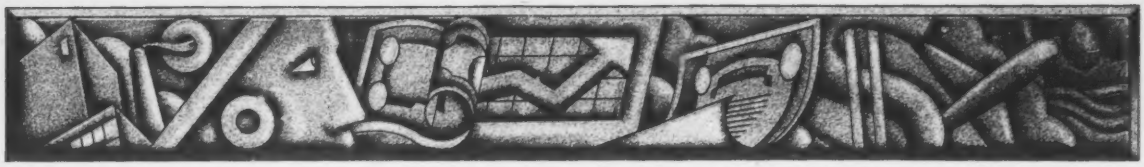
INC.: It's fine if you're feeling that way, but CEOs are people, too. What if they're feeling battered?

BLAISDELL: Mostly, I'm arguing for candor, for sharing the reality of the situation as they see it with the rest of the organization and talking about their ideas for improving things. People want to hear what the person at the top is thinking. Sharing concerns and ideas can be a very positive force.

If I were running a company, I'd also look around the organization for the people who are most positive about the future. Maybe the sales manager or a young engineer working on a new product line. I'd get them in front of employees and have them share what they see. Every organization has people who are feeling up about the future, who are making important inroads. When CEOs are feeling down, they should tap into those people.

The strongest investment a business owner can make is to tap the potential of the organization's people by communicating a vision of the future, enlisting everyone's support, and sharing in the success. ❑

EXECUTIVE-COMPENSATION SURVEY (continued)



HARD KNOCKS

Compensation mistakes you can learn from

Talk to any owner-manager who has been in business awhile and you'll get an earful on executive-compensation incentives that have backfired—usually because of insufficient planning, excessive costs, or management blunders. These are some mistakes you'll want to avoid:

■ **Building in performance disincentives.** "We had a gain-sharing plan that was so complicated people here called it a pain-sharing plan," recalls Anthony Harnett, CEO of Bread & Circus, a $60-million whole-foods supermarket chain headquartered in Newton, Mass. The plan's basic concept seemed appealing: any department that exceeded its profitability goals would receive quarterly bonuses from the gain-sharing pool. "But people began complaining about their targets, and the result was that everyone negotiated for the lowest possible platform from which to be measured. It came down to who could negotiate best, not who would perform best. So we gave it up and switched to a 401(k) plan for everyone."

■ **Failing to monitor bottom-line results.** "I didn't take a raise for five years because I brought in a very expensive VP of sales and I felt as though I was investing my money in our company's future," says Joe Schulman of Sentry Chemical Co. And for a while, the company's sales did rise. But because of the cost of the executive's salary, perks, and expense account charges, and the additional staff he required, overall profit margins dropped fast. "After a few years I figured out that I had to evaluate the overall cost of having him in the business. And the results showed he wasn't worth it. Once I let him go, our sales dropped off a little, but profitability increased tremendously."

■ **Giving away the store.** "When I was starting out, I had this tendency to ignore the things that I was uniquely doing for my business—like taking all the financial risk. So I would be very quick to give my top employees shares of the company," says Marshall Rafal, whose $1-million chemical software company, OLI Systems Inc., is based in Morris Plains, N.J. "As we grew larger and more profitable, I wanted to get those shares back under my control, but that meant spending a lot of the company's money to buy them back. And in some cases, I still haven't been able to afford it."

■ **Designing excessively complex plans.** "We set up a profit-sharing plan because we wanted to reward longevity," says Carl Unrein, chief executive of Ambulance Service Co., a $6.8-million medical transportation company in Denver. Unfortunately, an insurance consultant suckered him into an administrative nightmare—a plan that allowed employees to make savings contributions that they could withdraw on demand. "We were buried under all the back-and-forthing of their giving us their money and then requesting it back whenever they felt they needed it. It wound up costing us $1 in administration costs for every $3 worth of assets we had—and we had $185,000 worth of assets the first year alone!" After three years of frustration Unrein canceled the plan, then switched to a plain-vanilla program offered by his banker. It permits profit-sharing contributions by the company only; it accomplishes the same corporate goals but costs just $2,000 a year to administer. ❑

RESOURCES

Looking for clear, comprehensible information about executive-compensation strategies geared specifically to your needs as the owner of a growing business? There's not much available, but here are some places to start:

■ **Read *Strategic Pay: Aligning Organizational Strategies and Pay Systems*, by Edward E. Lawler III** (Jossey-Bass Inc., 350 Sansome St., San Francisco CA 94104, $26.95). Here's a savvy, straightforward book that analyzes compensation strategies according to their financial and management results.

■ **Subscribe to *Compensation & Benefits Manager's Report*** (Prentice Hall Professional Newsletters, 113 Sylvan Ave., Englewood Cliffs NJ 07632, $191.40 per year), an eight-page biweekly newsletter with quick tips on the latest strategies, analyzed down to their tax and legal implications. It's well worth the price, since articles are directed toward bottom-line savings.

■ **Attend seminars offered by the American Compensation Association, or ACA,** (P.O. Box 29312, Phoenix AZ 85038-9312). Best suited for human resources staffers, with topics such as how to design executive-compensation programs and executive incentives.

■ **Computerize with the help of *Software for Compensation Professionals: A Directory of Resources*** from the ACA (see above; $85, $75 for members). It'll show you software that can help you broaden your compensation program before you hire outside consultants.

GREAT EXPECTATIONS

As part of our survey, we asked CEOs to tell us their outlook for the coming year. Here's what they said:

Respondents' outlook for 1990	Expect a downturn	Expect improvement	Expect little or no change
For the overall economy	29%	20%	50%
For their region	25	35	40
For their industry	23	40	37
For their company's sales	9	75	15
For their company's profits	14	66	20

HANDS ON

A MANAGER'S NOTEBOOK

COMMUNITY SERVICE

Money Talks

Business owners looking to give grass-roots entrepreneurship a boost can support Accion International, a nonprofit organization that lends money to Latin American small businesses and is expanding its operations into the United States. Through Accion's Bridge Fund, investors deposit $10,000 in an 18-month certificate of deposit. Five percent of the interest goes to the investor. Anything else the CD earns pays for Accion's administrative costs.

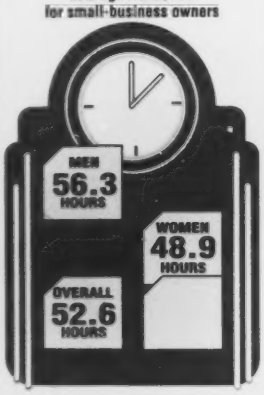
The $2-million Bridge Fund backs letters of credit for loans made by local Accion affiliates. The loans have been spread out among 40,000 tailors, fruit merchants, mechanics, and others, who received an average of $227 each. Last year the default rate was only 2%.

For more information, write Accion International, 130 Prospect St., Cambridge MA 02139, or call (617) 492-4930. ❑

MARK KATZMAN

TIME MANAGEMENT

THE MYTH OF THE 70-HOUR WORKWEEK



Source: Survey of 1,000 small-business owners with 10 or fewer employees. United Group Information Services, Hurst, Tex., 1990

Valarie Wilson (second from right) at a QUIT meeting

MEETINGS

Informed Excitement

"After a tough time growing this company, people felt like quitting," says Valarie Wilson, chairman and CEO of Wilson Sculley Associates Inc., a St. Louis advertising firm. "They wondered what all their hard work was for." Once a quarter, Wilson lifts sagging spirits with a Saturday morning QUIT (quarterly internal talks) meeting.

Six meetings and one and a half years later, not one of her employees has quit.

Wilson believes that by seeing the numbers and plans typically reserved for board members, employees know exactly where they fit in. But she's convinced that it's the entertaining and often-offbeat presentations that really make the Saturday morning meetings work. At one quarterly meeting that used a sports motif, managers announced lineup changes in the organizational chart; posted scores for profitability, sales, and overhead for the first half of the year; and unveiled the strategy for the second half of the year.

Why hold meetings on Saturday? Employees aren't distracted then, notes Wilson, who has seen the company grow from $8.8 million in billings in 1989 to $15 million in gross billings this year. ❑

CUSTOMER SERVICE

Ideas in Motion

Like other businesses, West Point Market, in Akron, has a suggestion box. But at West Point you never know where it will turn up.

If you keep the box in the same spot, says company president Russell Vernon, people tend to forget it's there. "If you keep it in one department," he says, "customers usually write only about that department; you won't get feedback about the rest of your store."

West Point doesn't put a suggestion box in every department, partly because its handmade wooden box is expensive. But more important, says Vernon, "it would probably annoy customers." ❑

REGULATIONS

Disability Diskette

BRUCE SANDERS

Confused about the Americans with Disabilities Act? You're not alone. The ADA regulation, enacted into law last summer, mandates major changes for countless U.S. businesses.

A group called International Resource Network on Disabilities has assembled everything you need to know about the ADA and put it on floppy disks. The information includes the actual bill and the congressional conference report, along with some practical tips on compliance with the act.

The disks run on IBM and Apple PCs and their compatibles. Send $5 for IBM disks or $6 for Apple disks to IRND, ADA Dept., 2232 S.W. 15th St., Fort Lauderdale FL 33312. Specify if you want the three-and-a-half-inch or the five-and-a-quarter-inch version. Or call the group at (305) 583-0645.

Two Washington, D.C., sources of more information: the President's Committee on Employment of People with Disabilities (1111 20th St. N.W., Washington DC 20036, 202-653-5044) offers a free information packet, and the Small Business Legislative Council has a compliance guide for $14.25, plus $1.50 postage and handling. (Orders for more than 25 copies will receive a discount.) To order, write the council, including your payment, at 1156 15th St. N.W., Suite 510, Washington DC 20005, or call (202) 639-8500. ❑

CHARTS: ELIOT BERGMAN

HANDS ON

BENEFITS

Data Trove

Now you can let your fingers do the walking when researching benefits packages for workers. The Employee Benefit Research Institute has packaged everything you need to know about benefits in *The EBRI DataBook*.

The 405-page reference tool is jammed full of surveys on costs and trends in benefits packages, including retirement plans, insurance, and child-care and vacation policies. It amasses information from a variety of sources and looks at it from the perspective of employers, program participants, and beneficiaries. The book costs $59.95 and is available from Johns Hopkins University Press, P.O. Box 4866, Hampden Station, Baltimore MD 21211, (301) 338-6946. ❑

ADVERTISING

Swapping Ads

Television commercials are expensive. So are newspaper ads. So what's the most cost-effective way to reach potential customers? For Stuart Skorman, president of Empire Video, the answer is to use other stores and businesses in the area to help get your message across.

Skorman, who runs Empire Video Superstore, a chain of five stores based in Keene, N.H., swaps free and half-price movie-rental coupons to area merchants in return for advertising space in their stores. Or he'll offer them advertising space in his stores or in his newsletter to his 17,000 customers. Each year the exchanges get 50,000 to 100,000 pieces of promotion per video store in customers' hands. "It would be hard not to find advertisements for our stores in any of the communities we're in," says Skorman. ❑

MARKETING

The Winning Ticket

We've all received direct mail promising unbelievable prizes inside, only to be disappointed when we opened it and found a hitch. However, one hitchless contest that's on the up and up and needs no explaining is a state-run lottery.

WALTER JOHNSON

Andy Juster (left) and Scott Pilato

Andy Juster and Scott Pilato, cofounders of $2-million-a-year Sunny Waterbeds & Accessories Inc., located in Orlando, decided to make good marketing use of their state lottery's credibility. They stuffed lottery tickets into mailings they sent to their top 100 retailers to announce a new line of bedroom furniture. The mailings specified when Sunny Waterbeds would follow up with a call. "Lottery ticket enclosed" was printed on the envelope.

The net result? When Sunny Waterbeds called a week later to announce the winning number, 70% of the prospects took the call and listened to its pitch. Usually 15% take the follow-up call on a mailing. "We were surprised," says Juster. "You wouldn't expect these people, who are really important, to hold on to a $1 lottery ticket for a week." ❑

CEO'S READING LIST

War As I Knew It
by George S. Patton Jr.
Bantam Books, 1989

"General George S. Patton would remind himself during critical decisions, Do not take counsel of your fears. There's a tremendous amount of wisdom in that because if you listen to your fears, you won't get anything accomplished.

"When the funding was almost in place to start ChemDesign, a key player backed out. I felt like throwing in the towel. There were nights I didn't sleep. I repeated to myself, Do not take counsel of your fears. I got on a plane to Cleveland, met with the investor, and persuaded him to rejoin the deal. Eventually I raised the $12 million I needed.

"Patton's autobiography is really about leadership principles. Employees expect their leader to be strong and well dressed. Patton had that pearl-handled revolver and those polished boots. Sometimes you see people who think managing means being buddy-buddy: dress sloppy, act sloppy, and be one of the troops. That doesn't work because you lose respect and you can't lead without the respect of your subordinates.

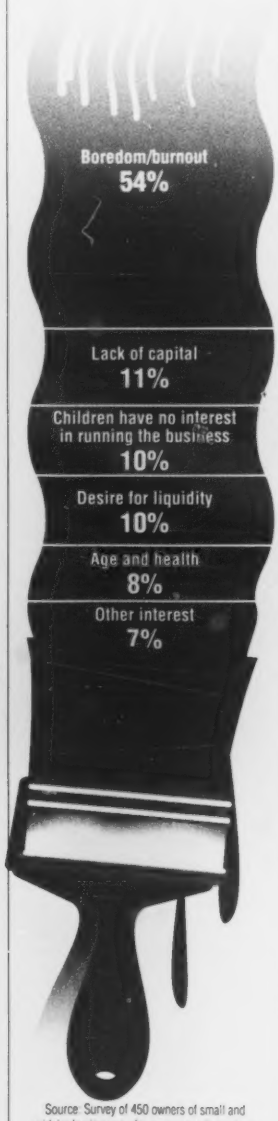
"Patton also led by example. He was a very spartan leader. He exposed himself to personal danger and the miseries of fighting at the front. The soldiers adored him for it. They would have followed him to hell."

—Dick Brooks, CEO of ChemDesign, Inc., Fitchburg, Mass.

SELLING OUT

BEATS WATCHING PAINT DRY

Why small-business owners want to sell



Source: Survey of 450 owners of small and midsize businesses who are prospective sellers. The Geneva Cos., Irvine, Calif., 1990

ON THE CHEAP

MEMORIES *By Cary Lu*

Does your computer have enough memory? Probably not. Nearly every new development in computing will require your computer to have more random access memory (RAM).

Since 1987 memory prices have dropped from more than $400 to less than $100 per megabyte. All Macintoshes can easily accept and use four or eight megabytes of memory. Although IBM PCs were stymied for years by MS-DOS with its 640-kilobyte RAM limit, Microsoft Windows 3.0, introduced earlier this year, finally allows programs to make effective use of more memory. Most current IBM PCs and compatibles can be upgraded to accept at least four megabytes of memory.

Memory prices are still high for two types of computers. Battery-operated portable computers need high-priced, low-power memory. And some 386-based desktop models require memory that still costs $200 to $300 per megabyte. If you have such a desktop computer, you might want to consider either getting a newer design or changing the main computer circuit board so you can install standard cheap memory.

Where can you buy it?

■ **Mail order** is the cheapest, at $50 to $60 a megabyte. Check the back pages of computer magazines. You'll have to install the memory yourself.

■ **Individuals who sell computer components** will often do on-site installation and typically charge $70 to $90 a megabyte. You're best off finding such people through referrals; try a local computer-user group or a university computing center.

■ **Computer stores** vary greatly in their memory pricing—typically charging $100 or more a megabyte. On-site installation can add $50 to $100. Since the memory chips are standard, pricing has little to do with quality, so shop for the lowest price at the level of service you need. ❑

INCENTIVES

One Day at a Time

Distant goals and deferred rewards can result in disillusioned employees. That's why at Seattle's Pacific Supply Co., workers take their bonuses one day at a time.

Every day that the apartment-supply company books $5,500 in sales, all 11 employees receive an extra half hour's pay. If daily sales hit $15,000, everyone racks up another 6 hours' wages. The previous year's sales provide the basis for Pacific's bonus targets. Paid out once a month, the bonuses accrue daily and in a typical month amount to an extra 20 hours' salary for each employee.

Since Pacific scrapped a monthly incentive program for a daily one, in 1986, sales have increased by more than half; turnover has plummeted to only one resignation in three years; and daily sales targets are hit four out of five days a week. And company president Michael Go says that because all employees share in the spoils, "instead of fostering individualism, we get teamwork." ❑

HIRING

Morning, Noon, and Night

BRUCE SANDERS

Some folks are morning people, some come to life at night, and others are bubbly all day. If you're in the service business, you want people who have a high energy level all day. How do you find them?

Barry Steinberg, president of $4-million Direct Tire Sales, a retail store in Watertown, Mass., always conducts three interviews with prospective employees on three separate days. One meeting takes place in the evening, a second at midday, and a third in the morning. "I get an indication of their energy level at all hours," says Steinberg. "I want people who are good with customers all day long." ❑

ENVIRONMENT

Paper in, Paper Out

Most office recycling programs begin with buying recycled goods and end with collecting wastepaper. But because of high prices, few businesses are willing to set up programs. Now there's good news on the recycling front: 100%-recycled computer paper and legal pads are available at competitive prices. One supplier charges $37.49 for a 2,700-form carton of recycled computer paper, $2.47 *less* than it charges for its virgin counterpart, while a dozen recycled-paper legal pads cost $9.99, only $1.20 more.

You can order them through your local office-supplies store or directly from Earth Care Paper Inc., (608) 277-2920; UARCO, (800) 877-4132; or Quill Corp., (708) 634-4800. ❑

Reported by Teri Lammers, Paul B. Brown, Jay Finegan, Anne Murphy, and Ellyn E. Spragins.

BUSINESS FOR SALE

SAN FRAN RESTRNT/PUB

THE BUSINESS A restaurant and pub in San Francisco's touristy Marina district, which was hard hit by last year's earthquake. Fifty-five-seat dining room, 85-seat bar; clientele that's young, single, and local. The adamantly ordinary cuisine—nothing sun-dried in view—is moderately priced: burgers and appetizers run about $6. But food isn't the money-maker here—liquor is. The bar accounts for 70% of sales and helps keep margins, after food, liquor, and labor costs, around 43%.

Financial Summary
(in $ thousands)

	1987	1988	1989
Gross sales	$918	$1,134	$1,295
Cost of food & liquor	221	287	338
Cost of labor	275	362	406

PRICE $750,000

SALES TRENDS Unlike much of the surrounding neighborhood, the business suffered little structural damage in the 1989 quake, but sales, which had been consistently rising, were down as much as 10% for some periods in 1990. California remains one of the most competitive restaurant markets in the country; San Francisco has one eatery for every 227 people. And this particular night spot, after eight years, may be getting old. Experts claim that restaurants typically enjoy 7- to 10-year life spans before their customers grow weary and their concept stale.

PRICE RATIONALE According to the insiders' formula of four to six times monthly sales, $650,000 is the best offer the seller should hope for. But he contends yearly cash flow's the *real* measure of his business. And his price is less than four times that amount, he points out.

PROS Location, location, location. Smack in the heart of a busy, safe neighborhood on the right side of town, this pub is, in many ways, sitting pretty—as weekend lines out the door attest.

CONS Business is off, and the restaurant discontinued its declining lunch trade last spring. It may lose 10% to 20% from its top line. Demographics indicate that a young, single, drinking clientele is more likely to shrink than grow. If this establishment's golden age is indeed past, the price may be out of line.

INC. has no stake in the sale of the business featured and cannot confirm the accuracy of financial or other information offered by the seller. Inquiries should be directed to GVA Mergers & Acquisitions Inc., in Phoenix.

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